

The University of Tennessee

**For the Year Ended
June 30, 1999**

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February 8, 2000

The Honorable Don Sundquist, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
The Honorable William B. Sansom, Chairman
Finance Committee
Board of Trustees
The University of Tennessee
Knoxville, Tennessee 37996-0180
and
Dr. J. Wade Gilley, President
The University of Tennessee
831 Andy Holt Tower
Knoxville, Tennessee 37996-0180

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the University of Tennessee for the year ended June 30, 1999. You will note from the independent auditor's report that an unqualified opinion was given on the fairness of the presentation of the financial statements.

Consideration of internal control over financial reporting and tests of compliance disclosed certain deficiencies, which are detailed in the Results of the Audit section of this report. The university's administration has responded to the audit findings; the responses are included following each finding. The Division of State Audit will follow up the audit to examine the application of the procedures instituted because of the audit findings.

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/sdr
99/083

State of Tennessee

Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit
The University of Tennessee
For the Year Ended June 30, 1999

AUDIT OBJECTIVES

The objectives of the audit were to consider the university's internal control over financial reporting; to determine compliance with certain provisions of laws, regulations, contracts, and grants; to determine the fairness of the presentation of the financial statements; and to recommend appropriate actions to correct any deficiencies.

INTERNAL CONTROL FINDINGS

Surplus or Missing Equipment Should be Removed from the Equipment System

The university does not remove surplus and missing equipment from its equipment inventory system in a timely manner. This reduces accountability for equipment and could result in inaccurate financial statements (page 8).

Custodial Services Should Be Obtained Through Bids

The University of Tennessee at Memphis obtained temporary custodial services under an existing blanket purchase order for clerical services. As a result, the custodial services, totaling \$51,424.00, were not properly obtained through bids (page 9).

The University Does Not Recalculate Certain Pell Awards and Does Not Monitor Withdrawals*

The University of Tennessee at Knoxville and the University of Tennessee at Memphis do not recalculate federal Pell Grant awards to students who fail to begin attending some of their classes. In addition, the University of Tennessee at Knoxville does not monitor the class attendance of financial aid recipients for evidence of unofficial withdrawal (page 10).

Federal Program Descriptions Should Be Communicated to Subrecipients

The university's contracts with subrecipients of federal funds do not communicate the Catalog of Federal Domestic Assistance (CFDA) program number or program title to the subrecipients (page 11).

One of the reportable conditions described above was considered a material weakness: the University of Tennessee did not remove surplus or missing equipment from its equipment system in a timely manner. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions (page 6).

* This finding is repeated from the prior audit.

OPINION ON THE FINANCIAL STATEMENTS

The opinion on the financial statements is unqualified.

"Audit Highlights" is a summary of the audit report. To obtain the complete audit report which contains all findings, recommendations, and management comments, please contact

Comptroller of the Treasury, Division of State Audit
1500 James K. Polk Building, Nashville, TN 37243-0264
(615) 741-3697

**Audit Report
The University of Tennessee
For the Year Ended June 30, 1999**

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The University of Tennessee For the Year Ended June 30, 1999

INTRODUCTION

POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the University of Tennessee. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which authorizes the Department of Audit to “perform currently a post-audit of all accounts and other financial records of the state government, and of any department, institution, office, or agency thereof in accordance with generally accepted auditing standards and in accordance with such procedures as may be established by the comptroller.”

Section 8-4-109, *Tennessee Code Annotated*, authorizes the Comptroller of the Treasury to audit any books and records of any state governmental entity that handles public funds when the Comptroller considers an audit to be necessary or appropriate.

BACKGROUND

The University of Tennessee was first established as Blount College in 1794 by the legislature of the Federal Territory. In 1807, the General Assembly renamed the institution East Tennessee College and in 1840 designated it a university. East Tennessee University was selected by the General Assembly to be Tennessee’s land-grant institution under the terms of the Morrill Act of 1862. In 1879, the General Assembly chose the school to be Tennessee’s state university and changed the name to the University of Tennessee.

Since its establishment, the university has grown into an institution with 23 different colleges and schools. With its primary campuses, various experiment stations, and extension services, the university provides services throughout the state. The main campus is in Knoxville; other campuses are in Memphis, Martin, and Chattanooga.

ORGANIZATION

The University of Tennessee is governed by the University of Tennessee Board of Trustees. In 1968, the board reorganized the institution into a university system, giving a central administrative staff the responsibility for the entire operation of the university and establishing on the primary campuses chancellors who are responsible for their respective campuses.

AUDIT SCOPE

The audit was limited to the period July 1, 1998, through June 30, 1999, and was conducted in accordance with generally accepted government auditing standards. Financial statements are presented for the year ended June 30, 1999. The University of Tennessee is an integral part of state government. As such, it has been included as a component unit in the *Tennessee Comprehensive Annual Financial Report*.

OBJECTIVES OF THE AUDIT

The objectives of the audit were

1. to consider the university's internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements;
2. to determine compliance with certain provisions of laws, regulations, contracts, and grants;
3. to determine the fairness of the presentation of the financial statements; and
4. to recommend appropriate actions to correct any deficiencies.

Although this audit was not intended to serve as an organization-wide audit as described in the Single Audit Act, as amended by the Single Audit Act Amendments of 1996, and Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, it included tests of compliance with applicable federal laws and regulations and consideration of internal control used in administering federal financial assistance programs. This audit is a segment of the organization-wide audit of the State of Tennessee, which is conducted in accordance with the Single Audit Act.

PRIOR AUDIT FINDINGS

Section 8-4-109, *Tennessee Code Annotated*, requires that each state department, agency, or institution report to the Comptroller of the Treasury the action taken to implement the recommendations in the prior audit report. The university filed its report with the Department of Audit on June 23, 1999. A follow-up of all prior audit findings was conducted as part of the current audit.

RESOLVED AUDIT FINDINGS

The current audit disclosed that the university has corrected previous audit findings concerning not following the university's purchasing policies, not promptly returning financial aid refunds, and improving the review of sole-source contracts. Some improvement was made regarding a prior audit finding concerning the need to properly approve contracts. The finding was not repeated.

REPEATED AUDIT FINDING

The prior audit report also contained a finding concerning the need to recalculate certain Pell awards and to monitor withdrawals. This finding has not been resolved and is repeated in this report.

OBSERVATIONS AND COMMENTS

TITLE IX OF THE EDUCATION AMENDMENTS OF 1972

Tennessee Code Annotated, Section 4-4-123, requires each state governmental entity subject to the requirements of Title IX of the Education Amendments of 1972 to submit an annual Title IX compliance report and implementation plan to the Department of Audit by June 30, 1999, and each June 30 thereafter. The University of Tennessee did not file its compliance report and implementation plan by June 30, 1999, in violation of this statutory requirement.

Title IX of the Education Amendments of 1972 is a federal law. The act requires all state government entities receiving federal money to develop and implement plans to ensure that no one receiving benefits under a federally funded education program and activity is discriminated against on the basis of gender. The untimely filing of the compliance report and implementation plan

required by state law does not necessarily mean that the university is not in compliance with the federal law.

RESULTS OF THE AUDIT

AUDIT CONCLUSIONS

Internal Control

As part of the audit of the university's financial statements for the year ended June 30, 1999, we considered internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements, as required by generally accepted government auditing standards. Reportable conditions, along with recommendations and management's responses, are detailed in the findings and recommendations. Consideration of internal control over financial reporting disclosed one material weakness.

Compliance

The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Fairness of Financial Statement Presentation

The Division of State Audit has rendered an unqualified opinion on the university's financial statements.

**Report on Compliance and on Internal Control
Over Financial Reporting Based on an Audit of
Financial Statements Performed in Accordance With
*Government Auditing Standards***

September 28, 1999

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the financial statements of the University of Tennessee, which is a component unit of the State of Tennessee, as of and for the year ended June 30, 1999, and have issued our report thereon dated September 28, 1999. We conducted our audit in accordance with generally accepted government auditing standards.

Compliance

As part of obtaining reasonable assurance about whether the university's financial statements are free of material misstatement, we performed tests of the university's compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

We did, however, note certain less significant instances of noncompliance, which we have reported to the university's management in a separate letter.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the university's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the university's ability to record, process, summarize, and report financial data consistent with management's assertions in the financial statements.

The following reportable conditions were noted:

- The University of Tennessee did not remove surplus or missing equipment from its equipment system in a timely manner.
- University personnel did not obtain bids for temporary custodial services.
- Class attendance was not monitored to determine if financial aid recipients had unofficially withdrawn or had not begun attending classes.
- Federal program descriptions are not adequately communicated to subrecipients.

These conditions are described in the Findings and Recommendations section of this report.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider the following to be a material weakness:

- The University of Tennessee did not remove surplus or missing equipment from its equipment system in a timely manner.

The Honorable John G. Morgan
September 28, 1999
Page Three

We also noted other matters involving the internal control over financial reporting, which we have reported to the university's management in a separate letter.

This report is intended solely for the information and use of the General Assembly of the State of Tennessee and management and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record.

Sincerely,

Arthur A. Hayes, Jr., CPA, Director
Division of State Audit

AAH/sdr

FINDINGS AND RECOMMENDATIONS

1. The University of Tennessee should remove surplus or missing equipment from its equipment system in a timely manner

Finding

University *Fiscal Policy*, Statement 5, Section 170, Part 3, states that “in order to maintain an accurate inventory system, corrections to the official inventory records must be made promptly to reflect trade-ins, sales of surplus items, theft, destruction, or transfers.”

The university is not removing the value of surplus and missing equipment from its on-line equipment inventory system in a timely manner. Of equipment tested valued at \$331,982.83 (80 items), surplus equipment valued at \$24,068.14 (7 items) had not been removed from the system. In four cases, the department had not prepared the necessary T-64 (change/deletion request form) to delete the item. In the three other cases, the department had prepared the form, but the information had never been entered on the university’s equipment system.

Many campus departments do not submit necessary T-64 forms or properly complete the forms. The forms must be properly approved and completed to initiate an equipment deletion. In addition, controller’s office personnel are not entering submitted T-64 forms on a current basis. They are allowed to accumulate and many are not posted until after year-end.

T-64’s are often submitted to the controller’s office with departmental inventories. Many campus departments do not perform their annual inventories on a timely basis or they fail to promptly return the signed inventory sheets to the controller’s office. As of July 30, 1999, for 257 of 3,047 equipment accounts (8.4%), department personnel had not submitted a fiscal year 1999 inventory to the controller’s office. Inventory verification sheets are distributed in November and university policies require that they be returned to the controller’s office within 60 days.

The university’s equipment system is used to provide current accountability for its equipment and to prepare its financial statements. Not promptly recording equipment deletions reduces the system’s usefulness in providing current, reliable accountability and could result in incorrect financial reporting.

Recommendation

The university should take steps to ensure that equipment change/deletion request forms (T-64’s) are submitted by departments promptly and correctly. Controller’s office personnel should quickly resolve any incomplete or incorrect T-64’s to accomplish necessary deletions. Submitted deletion forms should be posted on a current basis. A monthly reconciliation should be done to check submitted T-64’s against system postings.

The university should take steps to ensure that departmental inventories are done on a timely basis and that the signed inventory sheets are promptly returned to the controller's office. Any necessary T-64's should be prepared and submitted.

Management's Comment

The university concurs with the finding. The Controller's Office will reemphasize the importance of the prompt and correct submission of equipment change/deletion request forms (T-64's) for all departments. With current full staffing, Controller's Office personnel should be able to quickly resolve incomplete or incorrect T-64's.

The Controller's Office will continue to attempt to get all departments to return their annual inventories. The 91.6% return rate has been accomplished by sending two reminder letters to the departments who have not submitted their inventories and by sending a list of these departments to the Chief Business Officers and internal audit.

2. University personnel should have obtained bids for temporary custodial services

Finding

The University of Tennessee at Memphis obtained temporary custodial services under an existing blanket purchase order for clerical services. As a result, the custodial services, totaling \$51,424, were not competitively obtained through bids.

The *Fiscal Policy* of the University of Tennessee states that vendor selection for purchases of \$5,000 and higher will be "based on competitive prices by soliciting written sealed bids from 15 vendors or the number of vendors on the Qualified Vendors List, whichever is less" (Statement 05, Section 50, Part 03). Based on discussions with purchasing department personnel at Memphis, the campus departments using the custodial services and approving the related invoices for payment were under the incorrect impression that the blanket purchase order for clerical services also covered custodial services.

Recommendation

University management should take steps to ensure that all Memphis departments know and follow the *Fiscal Policy* pertaining to purchasing. In approving invoices for payment, departmental personnel should make sure that expenditures are in compliance with applicable purchase orders. The UT Memphis purchasing department should obtain temporary custodial services via competitive bidding as required by the university's *Fiscal Policy*.

Management's Comment

The University concurs with the finding. The blanket purchase order specifically indicated that it only covered services under a referenced term contract for temporary clerical services. Apparently confirming invoices for temporary custodial services with the same vendor were processed for payment under the blanket purchase order. This error should have been discovered at the using department level prior to approving the invoices for payment.

The following corrective action has been taken to guard against similar occurrences in the future:

1. Personnel in the using department were instructed to carefully review all invoices and make sure they are processed for payment against the correct purchase order.
2. Purchasing office buying staff were advised to give more precise descriptions of the contracted goods or service on blanket purchase orders issued against contracts. For example, a description of "temporary clerical personnel services" instead of "temporary personnel services" could have been used on the blanket order in question.
3. Since the time of the reported occurrence, separate contracts have been bid and awarded for temporary custodial personnel.

3. **Class attendance was not monitored to determine if financial aid recipients had unofficially withdrawn or had not begun attending classes**

Finding

As noted in the previous audit, the University of Tennessee at Knoxville does not monitor class attendance for evidence of unofficial withdrawals or failure to begin attending classes. As a result, the university does not process refunds or recalculate Pell awards for Title IV recipients who cease attending all or a portion of their classes. The 1998-1999 *Student Financial Aid Handbook*, chapter 3, page 85, states, "Participating SFA [Student Financial Aid] schools are expected to monitor student attendance for the purpose of determining a withdrawal date in the case of unofficial withdrawal." Additionally, chapter 4, page 66, states, "If the student does not begin attendance in all of his or her classes, the school must recalculate the student's [Pell] award based on the lower enrollment status."

In addition, the University of Tennessee at Memphis does not recalculate federal Pell awards to students who fail to begin attending some of their classes. The unofficial withdrawal of student financial aid recipients from all classes is monitored; however, those who fail to begin attending a portion of their classes are not detected through this procedure.

The absence of a procedure to monitor financial aid recipients for unofficial withdrawal or to determine if Pell recipients fail to begin attending each of their classes could result in an overaward to some recipients or in a failure to make necessary refunds.

The university has developed procedures at Knoxville to monitor unofficial withdrawal and, at Knoxville and Memphis, to determine if Pell recipients begin attending each registered class. The procedures are to be implemented in the fall semester of 1999.

Recommendation

The university should continue its efforts to implement these procedures. Refunds and repayments should be made whenever the university determines a financial aid recipient has unofficially withdrawn, and Pell awards should be recalculated whenever a Pell recipient fails to begin attending each class.

Management's Comment

The University concurs with the finding. For the Knoxville campus beginning Fall Semester 1999, a certification of attendance was done on the corrected 14 day class rolls. At the end of the semester, a final check on student attendance will be made with the grade of FX, which is available for faculty to use on grade reports to identify students who failed because they ceased attending class. Refunds and repayments will be made whenever the university determines a financial aid recipient has unofficially withdrawn, and Pell awards will be recalculated whenever a Pell recipient fails to begin attending each class.

The Memphis campus has developed a process in which each Pell recipient is given a document at the beginning of the semester which will record the instructor's certification that the Pell recipients began attending each class. Financial aid already has a module in the financial aid system which can produce, track and follow-up the certification process. Pell awards will be recalculated whenever a Pell recipient fails to begin attending each class.

4. Federal program descriptions should be communicated to subrecipients

Finding

The university's contracts with subrecipients of federal funds at the Memphis campus and at the Institute of Agriculture do not communicate the Catalog of Federal Domestic Assistance (CFDA) program number or program title to the subrecipients.

The *Office of Management and Budget Circular A-133*, Subpart D, Section 400(d), states,

A pass-through entity shall perform the following for the Federal awards it makes:
(1) Identify Federal awards made by informing each subrecipient of CFDA title and number, award name and number, award year if the award is R&D [Research & Development], and name of Federal agency.

University personnel were not aware of the requirement to communicate CFDA program numbers and program titles to subrecipients.

If the university does not communicate adequate Catalog of Federal Domestic Assistance descriptions to subrecipients, the subrecipients may not be able to correctly prepare schedules of expenditures of federal awards. Also, subrecipients may not be aware of related compliance requirements which could lead to noncompliance with federal laws and regulations.

Recommendation

University management should take steps to ensure that relevant CFDA information is disclosed to each subrecipient in the subcontract. Policies and procedures pertaining to federal subcontracts at all campuses should include procedures that outline the CFDA information to be included in subrecipient agreements.

Management's Comment

The University concurs with the finding. The University will instruct all offices that prepare subcontracts to be certain that relevant CFDA information is disclosed to each subrecipient in each subcontract.

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Independent Auditor's Report

September 28, 1999

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the accompanying balance sheet of the University of Tennessee, which is a component unit of the State of Tennessee, as of June 30, 1999, and the related statements of changes in fund balances and current funds revenues, expenditures, and other changes for the year then ended. These financial statements are the responsibility of the university's management. Our responsibility is to express an opinion on these financial statements, based on our audit.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the University of Tennessee, as of June 30, 1999, and the

The Honorable John G. Morgan
September 28, 1999
Page Two

changes in fund balances and the current funds revenues, expenditures, and other changes for the year then ended in conformity with generally accepted accounting principles.

As discussed in Note 12 to the financial statements, the university made changes in accounting methods to conform with generally accepted accounting principles. These changes pertained to methods of accounting for annuities payable and governmental grants and contracts and methods of reporting restricted fund balances for quasi-endowment funds and unexpended plant funds.

The Year 2000 Disclosures on page 48 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and do not express an opinion on it. In addition, we do not provide assurance that the university is or will become year 2000 compliant, that the university's year 2000 remediation efforts will be successful in whole or in part, or that parties with which the university does business are or will become year 2000 compliant.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 28, 1999, on our consideration of the university's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants.

Sincerely,

Arthur A. Hayes, Jr., CPA, Director
Division of State Audit

AAH/sdr

THE UNIVERSITY OF TENNESSEE
BALANCE SHEET
JUNE 30, 1999, WITH TOTALS AS OF JUNE 30, 1998

	Current Funds					Plant Funds	
	Unrestricted	Restricted	Loan Funds	Endowment and Similar Funds	Annuity and Life Income Funds	Unexpended	Retirement of Indebtedness and Renewals and Replacements
ASSETS							
Cash and cash equivalents (Note 2)	\$ 157,265,210.40	\$ 30,749,340.63	\$ 4,387,227.20	\$ 4,183,121.67	\$ 1,805,800.05	\$ -	\$ 141,735,882.45
Assets with UHS Ventures, Inc. (Notes 2 and 14)	6,679,250.23	-	-	-	-	-	-
Assets with trustees (Notes 2 and 9)	-	324,984.78	-	3,904,239.09	-	-	770,555.10
Investments (Note 2)	-	365,940.65	-	369,042,592.23	53,384,556.22	139,700.00	-
Accounts receivable (net of allowance of \$47,985,918.68 at June 30, 1999, and \$46,085,484.97 at June 30, 1998)	82,901,588.91	56,065,646.27	851,826.71	2,039,763.88	10,750.48	-	9,235.74
Notes receivable (net of allowance of \$1,203,144.19 at June 30, 1999, and \$1,158,646.47 at June 30, 1998)	-	-	33,833,087.74	-	-	-	-
State capital outlay and maintenance receivable	-	-	-	-	-	1,886,169.06	-
Tennessee State School Bond Authority debt proceeds receivable	-	-	-	-	-	2,332,245.83	-
Due from other funds	374,757.11	-	-	-	-	-	4,794,602.57
Inventories	10,469,203.60	-	-	-	-	-	-
Prepaid expenses and deferred charges	3,697,630.08	-	-	-	-	-	-
Land	-	-	-	-	-	-	-
Structures and improvements	-	-	-	-	-	-	-
Machinery and equipment	-	-	-	-	-	-	-
Library holdings	-	-	-	-	-	-	-
Livestock	-	-	-	-	-	-	-
Total assets	<u>\$ 261,387,640.33</u>	<u>\$ 87,505,912.33</u>	<u>\$ 39,072,141.65</u>	<u>\$ 379,169,716.87</u>	<u>\$ 55,201,106.75</u>	<u>\$ 4,358,114.89</u>	<u>\$ 147,310,275.86</u>
LIABILITIES AND FUND BALANCES							
Liabilities:							
Accounts payable	\$ 54,893,260.01	\$ 3,228,667.35	\$ -	\$ 1,227,494.55	\$ -	\$ 6,603,127.40	\$ -
Accrued liabilities	26,665,793.05	350,720.69	-	-	-	-	-
Tennessee State School Bond Authority indebtedness (Note 4)	-	-	-	-	-	2,332,245.83	-
Due to other funds	-	-	-	-	374,757.11	4,794,602.57	-
Annuities payable	-	-	-	-	8,617,026.33	-	-
Notes payable (Note 4)	-	-	-	-	-	-	-
Accrued compensated absences	51,831,935.45	-	-	-	-	-	-
Lease obligations payable (Note 6)	-	-	-	-	-	-	-
Deferred revenue	26,761,127.76	-	-	-	-	-	-
Amounts held in custody for the university	-	-	-	-	-	-	-
Amounts held in custody for others	-	-	-	-	-	-	-
Deposits payable	3,940,423.01	-	-	-	-	-	-
Total liabilities	<u>164,092,539.28</u>	<u>3,579,388.04</u>	<u>-</u>	<u>1,227,494.55</u>	<u>8,991,783.44</u>	<u>13,729,975.80</u>	<u>-</u>
Fund balances:							
Allocation for working capital	90,839,113.29	-	-	-	-	-	-
Allocation for encumbrances (Note 10)	9,014,160.92	-	-	-	-	-	-
Allocation for compensated absences	(51,831,935.45)	-	-	-	-	-	-
Other allocations	14,155,728.26	-	-	-	-	-	-
Restricted	-	83,926,524.29	-	-	-	-	-
U.S. Government grants refundable - restricted	-	-	31,721,492.77	-	-	-	-
Institutional loan funds - restricted	-	-	7,350,648.88	-	-	-	-
Endowment	-	-	-	355,438,052.11	-	-	-
Quasi-endowment - unrestricted	-	-	-	7,394,189.35	-	-	-
Quasi-endowment - restricted	-	-	-	15,109,980.86	-	-	-
Annuities	-	-	-	-	13,990,501.64	-	-
Life income	-	-	-	-	32,218,821.67	-	-
Plant - unrestricted	-	-	-	-	-	(10,190,931.05)	146,371,939.70
Plant - restricted	-	-	-	-	-	819,070.14	938,336.16
Net investment in plant	-	-	-	-	-	-	-
Unallocated	35,118,034.03	-	-	-	-	-	-
Total fund balances	<u>97,295,101.05</u>	<u>83,926,524.29</u>	<u>39,072,141.65</u>	<u>377,942,222.32</u>	<u>46,209,323.31</u>	<u>(9,371,860.91)</u>	<u>147,310,275.86</u>
Total liabilities and fund balances	<u>\$ 261,387,640.33</u>	<u>\$ 87,505,912.33</u>	<u>\$ 39,072,141.65</u>	<u>\$ 379,169,716.87</u>	<u>\$ 55,201,106.75</u>	<u>\$ 4,358,114.89</u>	<u>\$ 147,310,275.86</u>

The notes to the financial statements are an integral part of this statement.

Exhibit A

Investment in Plant	Agency Funds	Total (Memorandum Only)		UHS Ventures, Inc. December 31, 1998	Total (Memorandum Only)	
		1999	1998		1999	1998
\$ -	\$ 5,218,161.00	\$ 345,344,743.40	\$ 306,173,806.28	\$ 6,080,888.00	\$ 351,425,631.40	\$ 310,693,196.28
-	-	6,679,250.23	5,180,899.20	-	6,679,250.23	5,180,899.20
-	-	4,999,778.97	2,903,918.84	-	4,999,778.97	2,903,918.84
-	4,500,026.76	427,432,815.86	360,645,834.12	2,536,892.00	429,969,707.86	361,783,564.12
-	865,042.72	142,743,854.71	151,723,225.68	2,248,455.00	144,992,309.71	153,480,859.68
-	-	33,833,087.74	32,078,486.80	-	33,833,087.74	32,078,486.80
-	-	1,886,169.06	623,712.88	-	1,886,169.06	623,712.88
-	-	2,332,245.83	3,452,900.81	-	2,332,245.83	3,452,900.81
-	-	5,169,359.68	5,048,670.08	-	5,169,359.68	5,048,670.08
-	-	10,469,203.60	9,849,484.23	-	10,469,203.60	9,849,484.23
-	-	3,697,630.08	4,069,996.95	183,482.00	3,881,112.08	4,158,246.95
37,951,133.03	-	37,951,133.03	34,652,903.21	-	37,951,133.03	34,652,903.21
1,188,200,474.84	-	1,188,200,474.84	1,121,244,050.57	117,287.00	1,188,317,761.84	1,121,399,083.57
434,885,615.34	-	434,885,615.34	425,728,740.64	429,729.00	435,315,344.34	426,035,348.64
249,544,291.00	-	249,544,291.00	245,629,966.00	-	249,544,291.00	245,629,966.00
1,884,764.00	-	1,884,764.00	1,877,042.00	-	1,884,764.00	1,877,042.00
<u>\$ 1,912,466,278.21</u>	<u>\$ 10,583,230.48</u>	<u>\$ 2,897,054,417.37</u>	<u>\$ 2,710,883,638.29</u>	<u>\$ 11,596,733.00</u>	<u>\$ 2,908,651,150.37</u>	<u>\$ 2,718,848,283.29</u>
\$ -	\$ 142,565.49	\$ 66,095,114.80	\$ 65,093,033.09	\$ 1,057,019.00	\$ 67,152,133.80	\$ 65,363,363.09
1,592,598.76	-	28,609,112.50	29,784,471.16	1,019,556.00	29,628,668.50	30,512,122.16
303,790,464.14	-	306,122,709.97	260,179,195.89	-	306,122,709.97	260,179,195.89
-	-	5,169,359.68	5,048,670.08	-	5,169,359.68	5,048,670.08
-	-	8,617,026.33	6,955,285.56	-	8,617,026.33	6,955,285.56
70,259.50	-	70,259.50	89,024.97	-	70,259.50	89,024.97
-	-	51,831,935.45	50,109,620.80	-	51,831,935.45	50,109,620.80
1,069,779.51	-	1,069,779.51	1,498,270.28	-	1,069,779.51	1,498,270.28
-	-	26,761,127.76	22,425,275.12	289,461.00	27,050,588.76	23,051,484.12
-	-	-	-	4,950,848.00	4,950,848.00	3,506,337.00
-	10,440,664.99	10,440,664.99	8,971,240.99	-	10,440,664.99	8,971,240.99
-	-	3,940,423.01	2,617,478.18	-	3,940,423.01	2,617,478.18
<u>306,523,101.91</u>	<u>10,583,230.48</u>	<u>508,727,513.50</u>	<u>452,771,566.12</u>	<u>7,316,884.00</u>	<u>516,044,397.50</u>	<u>457,902,093.12</u>
-	-	90,839,113.29	92,665,824.99	-	90,839,113.29	92,665,824.99
-	-	9,014,160.92	10,743,210.30	-	9,014,160.92	10,743,210.30
-	-	(51,831,935.45)	(50,109,620.80)	-	(51,831,935.45)	(50,109,620.80)
-	-	14,155,728.26	13,284,484.69	-	14,155,728.26	13,284,484.69
-	-	83,926,524.29	79,875,241.65	-	83,926,524.29	79,875,241.65
-	-	31,721,492.77	31,152,013.25	-	31,721,492.77	31,152,013.25
-	-	7,350,648.88	6,976,169.71	-	7,350,648.88	6,976,169.71
-	-	355,438,052.11	314,626,638.34	-	355,438,052.11	314,626,638.34
-	-	7,394,189.35	6,375,175.51	-	7,394,189.35	6,375,175.51
-	-	15,109,980.86	14,203,282.34	-	15,109,980.86	14,203,282.34
-	-	13,990,501.64	13,070,581.85	-	13,990,501.64	13,070,581.85
-	-	32,218,821.67	24,073,394.35	-	32,218,821.67	24,073,394.35
-	-	136,181,008.65	108,915,949.62	-	136,181,008.65	108,915,949.62
-	-	1,757,406.30	4,315,210.91	-	1,757,406.30	4,315,210.91
1,605,943,176.30	-	1,605,943,176.30	1,568,411,329.22	-	1,605,943,176.30	1,568,411,329.22
-	-	35,118,034.03	19,533,186.24	4,279,849.00	39,397,883.03	22,367,304.24
<u>1,605,943,176.30</u>	<u>-</u>	<u>2,388,326,903.87</u>	<u>2,258,112,072.17</u>	<u>4,279,849.00</u>	<u>2,392,606,752.87</u>	<u>2,260,946,190.17</u>
<u>\$ 1,912,466,278.21</u>	<u>\$ 10,583,230.48</u>	<u>\$ 2,897,054,417.37</u>	<u>\$ 2,710,883,638.29</u>	<u>\$ 11,596,733.00</u>	<u>\$ 2,908,651,150.37</u>	<u>\$ 2,718,848,283.29</u>

THE UNIVERSITY OF TENNESSEE
STATEMENT OF CHANGES IN FUND BALANCES
FOR THE YEAR ENDED JUNE 30, 1999

	Current Funds					Plant Funds			Totals (Memorandum Only) 1999	UHS Ventures, Inc. December 31, 1998	Totals (Memorandum Only) 1999
	Unrestricted	Restricted	Loan Funds	Endowment and Similar Funds	Annuity and Life Income Funds	Unexpended	Retirement of Indebtedness and Renewals and Replacements	Investment in Plant			
REVENUES AND OTHER ADDITIONS											
Unrestricted current funds revenues	\$ 1,063,780,987.47	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 1,063,780,987.47	\$ -	\$ 1,063,780,987.47
Restricted gifts and grants	-	250,900,786.30	-	16,646,267.23	10,706,175.79	-	-	-	278,253,229.32	-	278,253,229.32
Federal Perkins loan funds	-	-	518,350.00	-	-	-	-	-	518,350.00	-	518,350.00
Federal nursing and health professions loan funds	-	-	152,184.18	-	-	-	-	-	152,184.18	-	152,184.18
Interest on notes receivable	-	-	747,499.49	-	-	-	-	-	747,499.49	-	747,499.49
Endowment income	-	9,728,761.53	88,322.71	516,155.34	-	-	-	-	10,333,239.58	-	10,333,239.58
Investment income	-	132,096.82	138,555.54	25,537,076.25	1,425,757.63	8,083.15	4,335,905.28	-	31,577,474.67	-	31,577,474.67
State appropriations for capital outlay	-	-	-	-	-	20,973,713.08	197,899.38	-	21,171,612.46	-	21,171,612.46
Tennessee State School Bond Authority proceeds	-	-	-	-	-	57,967,476.51	-	-	57,967,476.51	-	57,967,476.51
Capital lease acquisitions	-	-	-	-	-	-	-	606,224.77	606,224.77	-	606,224.77
Gifts and other sources	-	-	78,359.71	-	-	8,960,195.09	1,172,324.42	8,767,706.92	18,978,586.14	-	18,978,586.14
Student debt service fees	-	-	-	-	-	-	3,111,325.76	-	3,111,325.76	-	3,111,325.76
Federal interest subsidy grants	-	-	-	-	-	-	309,117.00	-	309,117.00	-	309,117.00
Expended for plant facilities (including \$41,276,886.52 charged to current fund expenditures)	-	-	-	-	-	-	-	135,866,972.06	135,866,972.06	-	135,866,972.06
Retirement of indebtedness	-	-	-	-	-	-	-	103,406,862.50	103,406,862.50	-	103,406,862.50
Component unit revenue	-	-	-	-	-	-	-	-	-	7,268,810.00	7,268,810.00
Total revenues and other additions	1,063,780,987.47	260,761,644.65	1,723,271.63	42,699,498.82	12,131,933.42	87,909,467.83	9,126,571.84	248,647,766.25	1,726,781,141.91	7,268,810.00	1,734,049,951.91
EXPENDITURES AND OTHER DEDUCTIONS											
Unrestricted current fund expenditures	990,825,541.14	-	-	-	-	-	-	-	990,825,541.14	-	990,825,541.14
Restricted current fund expenditures	-	239,288,548.78	-	-	-	-	-	-	239,288,548.78	-	239,288,548.78
Administration and collection costs	-	-	95,640.81	-	-	-	-	-	95,640.81	-	95,640.81
Loan cancellations and write-offs	-	-	563,204.80	-	-	-	-	-	563,204.80	-	563,204.80
Expended for plant facilities (including \$10,310,308.36 of uncapitalized expenditures)	-	-	-	-	-	103,820,184.73	1,080,209.17	-	104,900,393.90	-	104,900,393.90
Retirement of indebtedness	-	-	-	-	-	-	16,563,031.88	-	16,563,031.88	-	16,563,031.88
Interest on indebtedness	-	-	-	-	-	-	12,136,932.73	-	12,136,932.73	-	12,136,932.73
Disposal of plant facilities	-	-	-	-	-	-	-	46,770.18	46,770.18	-	46,770.18
Buildings and improvements written off and adjustments	-	-	-	-	-	-	-	301,375.11	301,375.11	-	301,375.11
Physical inventory adjustments	-	-	-	-	-	-	-	60,137,773.79	60,137,773.79	-	60,137,773.79
Capital lease additions	-	-	-	-	-	-	-	177,734.00	177,734.00	-	177,734.00
Increase in indebtedness	-	-	-	-	-	-	-	150,452,266.09	150,452,266.09	-	150,452,266.09
Indirect costs recovered	-	20,011,793.12	-	-	-	-	-	-	20,011,793.12	-	20,011,793.12
Adjustment of actuarial liability for annuities payable	-	-	-	-	66,865.26	-	-	-	66,865.26	-	66,865.26
Component unit expenses	-	-	-	-	-	-	-	-	-	5,823,079.00	5,823,079.00
Other	-	697,457.60	223,270.16	-	77,710.86	-	-	-	998,438.62	-	998,438.62
Total expenditures and other deductions	990,825,541.14	259,997,799.50	882,115.77	-	144,576.12	103,820,184.73	29,780,173.78	211,115,919.17	1,596,566,310.21	5,823,079.00	1,602,389,389.21

THE UNIVERSITY OF TENNESSEE
STATEMENT OF CHANGES IN FUND BALANCES
FOR THE YEAR ENDED JUNE 30, 1999

	Current Funds					Plant Funds			Totals (Memorandum Only) 1999	UHS Ventures, Inc. December 31, 1998	Totals (Memorandum Only) 1999
	Unrestricted	Restricted	Loan Funds	Endowment and Similar Funds	Annuity and Life Income Funds	Unexpended	Retirement of Indebtedness and Renewals and Replacements	Investment in Plant			
<u>TRANSFERS AMONG FUNDS -</u>											
<u>ADDITIONS (DEDUCTIONS)</u>											
Mandatory:											
Principal and interest	(24,695,503.07)	-	-	-	-	-	24,695,503.07	-	-	-	-
Loan funds matching	(131,562.83)	28,760.00	102,802.83	-	-	-	-	-	-	-	-
Endowment and similar funds	-	-	-	2,922,010.19	(2,922,010.19)	-	-	-	-	-	-
Nonmandatory:											
Restricted current funds	(1,181,448.45)	3,258,677.49	-	(2,901,160.88)	-	794,519.99	29,411.85	-	-	-	-
Endowment and similar funds	(16,778.00)	-	-	16,778.00	-	-	-	-	-	-	-
Unexpended plant	(6,645,432.10)	-	-	-	-	14,061,487.15	(7,416,055.05)	-	-	-	-
Retirement of indebtedness	(29,106,706.25)	-	-	-	-	-	29,106,706.25	-	-	-	-
Total transfers	(61,777,430.70)	3,287,437.49	102,802.83	37,627.31	(2,922,010.19)	14,856,007.14	46,415,566.12	-	-	-	-
Net increase (decrease) for the year	11,178,015.63	4,051,282.64	943,958.69	42,737,126.13	9,065,347.11	(1,054,709.76)	25,761,964.18	37,531,847.08	130,214,831.70	1,445,731.00	131,660,562.70
Fund balance at July 1, 1998, restated	86,117,085.42	79,875,241.65	38,128,182.96	335,205,096.19	37,143,976.20	(8,317,151.15)	121,548,311.68	1,568,411,329.22	2,258,112,072.17	2,834,118.00	2,260,946,190.17
Fund balance at June 30, 1999	<u>\$ 97,295,101.05</u>	<u>\$ 83,926,524.29</u>	<u>\$ 39,072,141.65</u>	<u>\$ 377,942,222.32</u>	<u>\$ 46,209,323.31</u>	<u>\$ (9,371,860.91)</u>	<u>\$ 147,310,275.86</u>	<u>\$ 1,605,943,176.30</u>	<u>\$ 2,388,326,903.87</u>	<u>\$ 4,279,849.00</u>	<u>\$ 2,392,606,752.87</u>

The notes to the financial statements are an integral part of this statement.

THE UNIVERSITY OF TENNESSEE
STATEMENT OF CURRENT FUNDS REVENUES, EXPENDITURES, AND OTHER CHANGES
FOR THE YEAR ENDED JUNE 30, 1999
WITH COMPARATIVE TOTALS FOR THE YEAR ENDED JUNE 30, 1998

Exhibit C

	Current Year			Prior Year
	Unrestricted	Restricted	Total	Total
REVENUES				
Tuition and fees	\$ 157,569,885.56	\$ -	\$ 157,569,885.56	\$ 145,769,441.48
Federal appropriation:	13,602,258.86	-	13,602,258.86	13,091,032.76
State appropriation:	373,206,500.00	11,889,480.70	385,095,980.70	362,984,833.03
Local appropriation:	3,073,655.49	-	3,073,655.49	2,734,554.05
Federal grants and contracts	14,890,102.66	97,739,974.34	112,630,077.00	112,826,284.63
State grants and contracts	2,232,541.98	23,642,458.17	25,875,000.15	21,073,467.46
Local grants and contracts	3,041,394.13	7,521,514.48	10,562,908.61	8,755,663.89
Private gifts, grants, and contract:	5,040,371.76	79,061,107.36	84,101,479.12	78,752,680.75
Endowment income - university and other	68,427.37	15,985,202.48	16,053,629.85	13,684,994.55
Sales and services of educational activities:	33,087,914.99	-	33,087,914.99	32,901,168.71
Investment income	12,954,418.02	-	12,954,418.02	13,930,965.49
Other sources	13,688,208.42	-	13,688,208.42	8,321,278.33
Total educational and general	632,455,679.24	235,839,737.53	868,295,416.77	814,826,365.13
Sales and services of auxiliary enterprises	116,273,035.64	51,797.20	116,324,832.84	107,578,796.00
Sales and services of hospitals	315,052,272.59	3,397,014.05	318,449,286.64	309,610,820.42
Total current revenues	1,063,780,987.47	239,288,548.78	1,303,069,536.25	1,232,015,981.55
EXPENDITURES AND TRANSFERS				
Educational and general expenditures:				
Instruction	272,433,897.30	49,532,917.33	321,966,814.63	308,069,202.19
Research	41,333,184.38	93,710,808.29	135,043,992.67	125,796,836.61
Public service	49,345,735.17	49,520,028.95	98,865,764.12	92,291,321.84
Academic support	72,432,947.77	7,187,713.55	79,620,661.32	73,183,447.62
Student services	42,800,033.77	2,090,356.83	44,890,390.60	41,080,197.63
Institutional support	58,100,760.53	3,130,504.81	61,231,265.34	57,359,523.89
Operation and maintenance of plant	50,707,544.75	191,731.99	50,899,276.74	48,660,118.30
Scholarships and fellowships	21,363,440.76	30,475,675.78	51,839,116.54	47,500,268.18
Total educational and general expenditures	608,517,544.43	235,839,737.53	844,357,281.96	793,940,916.26
Mandatory transfers for:				
Principal and interest	4,371,056.19	-	4,371,056.19	4,271,470.42
Loan funds	131,562.83	-	131,562.83	161,866.28
Nonmandatory transfers for:				
Retirement of indebtedness	23,527,328.94	-	23,527,328.94	15,142,150.92
Endowment and similar funds	16,778.00	-	16,778.00	12,000.00
Restricted current funds	1,161,448.45	-	1,161,448.45	(20,882.56)
Unexpended plant	425,414.88	-	425,414.88	970,596.23
Auxiliary enterprises	(3,836,277.27)	-	(3,836,277.27)	(4,307,013.52)
Hospitals	(1,620,797.86)	-	(1,620,797.86)	(1,984,018.48)
Total educational and general expenditures and transfers	632,694,058.59	235,839,737.53	868,533,796.12	808,187,085.55
Auxiliary enterprises				
Expenditures	90,720,726.01	51,797.20	90,772,523.21	84,830,586.39
Mandatory transfer for:				
Principal and interest	12,318,030.89	-	12,318,030.89	11,605,616.44
Nonmandatory transfers for:				
Retirement of indebtedness	5,579,377.31	-	5,579,377.31	5,612,500.30
Unexpended plant	1,578,279.53	-	1,578,279.53	1,285,684.09
Restricted current funds	20,000.00	-	20,000.00	17,660.00
Educational and general	3,836,277.27	-	3,836,277.27	4,307,013.52
Total auxiliary enterprises expenditures and transfer:	114,052,691.01	51,797.20	114,104,488.21	107,659,060.74
Hospitals:				
Expenditures	291,587,270.70	3,397,014.05	294,984,284.75	288,038,264.87
Mandatory transfer for:				
Principal and interest	8,006,415.99	-	8,006,415.99	10,456,082.53
Nonmandatory transfers for:				
Educational and general	1,620,797.86	-	1,620,797.86	1,984,018.48
Endowment and similar funds	-	-	-	35,000.00
Retirement of indebtedness	-	-	-	8,000,000.00
Unexpended plant	4,641,737.69	-	4,641,737.69	2,093,141.46
Total hospitals expenditures and transfers	305,856,222.24	3,397,014.05	309,253,236.29	310,606,507.34
Total expenditures and transfers	1,052,602,971.84	239,288,548.78	1,291,891,520.62	1,226,452,653.63
Excess (deficiency) revenues over (under) expenditures and transfers				
Educational and general	(238,379.35)	-	(238,379.35)	6,639,279.58
Auxiliary enterprises	2,220,344.63	-	2,220,344.63	(80,264.74)
Hospitals	9,196,050.35	-	9,196,050.35	(995,686.92)
OTHER TRANSFERS AND ADDITIONS (DEDUCTIONS):				
Restricted receipts in excess of expenditures	-	21,473,095.87	21,473,095.87	23,829,452.40
Indirect costs recovered	-	(20,011,793.12)	(20,011,793.12)	(19,270,516.13)
Other deductions	-	(697,457.60)	(697,457.60)	(695,735.71)
Restricted gifts transferred from (to) other funds	-	3,287,437.49	3,287,437.49	(3,056,436.61)
Net increase in fund balances	\$ 11,178,015.63	\$ 4,051,282.64	\$ 15,229,298.27	\$ 6,370,091.87

The notes to the financial statements are an integral part of this statement

The University of Tennessee
Notes to the Financial Statements
June 30, 1999

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The university is a component unit of the State of Tennessee, and is discretely presented in the *Tennessee Comprehensive Annual Financial Report*. Although the university is a separate legal entity, the state is financially accountable for the university because the state appoints a majority of its governing body and provides financial support.

The University of Tennessee System is comprised of the University of Tennessee, Knoxville; the University of Tennessee at Chattanooga; the University of Tennessee at Martin; the University of Tennessee - Center for the Health Sciences, including the Memphis campus, the Memorial Research Center at Knoxville, Clinical Education Centers at Chattanooga and Knoxville, Family Practice Centers at Jackson, Knoxville, and Memphis, and hospitals in Knoxville and Memphis; the University of Tennessee Space Institute at Tullahoma; the University of Tennessee Institute of Agriculture, including the College of Agriculture at Knoxville, the Agricultural Experiment Stations, the Agricultural Extension Service, and the College of Veterinary Medicine at Knoxville; the Institute for Public Service, which includes the County Technical Assistance Service and the Municipal Technical Advisory Service; and the University-Wide Administration. The university is governed by a board of 19 members, including one student member, all appointed by the governor, who also serves as chairman. The President is the Chief Executive Officer of the university system.

As required by generally accepted accounting principles, these financial statements present the financial position and financial activities of the university and its component unit as well as certain activities and expenditures funded by other state agencies on behalf of the university or its employees. The component unit discussed below is included in the university's financial reporting entity because the university has appointment authority of its board. The component unit is presented discretely in a separate column in the combined financial statements to emphasize it is legally separate from the university.

Discretely Presented Component Unit

As of December 16, 1998, University Health System, Inc., a component unit of the university, changed its name to UHS Ventures, Inc., via charter amendment. On May 14, 1999, a new corporation was formed for the express purpose of operating UT

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Notes to the Financial Statements (Cont.)
June 30, 1999

Memorial Research Center and Hospital. It assumed the name University Health System, Inc.

UHS Ventures was formed to provide practice management and other administrative services to physician groups, physician associations, and the University of Tennessee Medical Center at Knoxville. Because the university controls the majority of the governing board, UHS Ventures must be presented as a component unit in accordance with GASB Statement 14, *The Financial Reporting Entity*. The transactions between the university and UHS Ventures will not agree in the accompanying financial statements because they have different fiscal year ends. All activity reported for UHS Ventures, including the information shown in the Notes to the Financial Statements, is as of and for the year ended December 31, 1998. Complete financial statements of UHS Ventures can be obtained from UHS Ventures, Inc., 9000-C Executive Park Drive, Knoxville, Tennessee 37923.

The university also benefits from a number of organizations that exist mainly to support the various purposes and activities of the university system. These organizations include student organizations; the University Faculty Association, Inc.; the University Physicians Foundation; the University of Chattanooga Foundation; the Tennessee Geographic Alliance; Tristar Enterprises, Inc.; and the Tennessee 4-H Club Foundation, Inc. Each of these organizations is legally independent and fully self-governing. Consequently, none of these organizations is included in the financial statements of the university.

Basis of Presentation

The financial statements for the University of Tennessee are prepared in accordance with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board. The university uses the AICPA College Guide model for accounting and financial reporting.

Basis of Accounting

The financial statements of the University of Tennessee have been prepared on the accrual basis except that depreciation on plant assets is not recorded and revenues and expenditures of an academic term encompassing more than one fiscal year are reported solely in the fiscal year in which the term is predominantly conducted. All unrestricted resources are reported as revenue in the year they are earned. All restricted resources are recorded as additions to the fund balances of the appropriate fund groups. Restricted current resources are then recorded as revenues during the period in which they are expended. The statement of current funds revenues, expenditures, and other

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Notes to the Financial Statements (Cont.)
June 30, 1999

changes is a statement of financial activities of current funds related to the current reporting period. It does not purport to present the results of operations or the net income or loss for the period, as would a statement of income or a statement of revenues and expenses.

To the extent that current funds are used to finance plant assets, the funds are accounted for as (1) expenditures, for normal replacement of movable equipment and library holdings; (2) mandatory transfers, for required debt amortization and interest and equipment renewal and replacement; and (3) nonmandatory transfers, for all other cases.

Fund Accounting

To ensure observance of limitations and restrictions placed on the use of resources available, the university maintains accounts in accordance with the principles of fund accounting. With this procedure, resources for various purposes are classified for accounting and reporting purposes into funds for specified activities or objectives. Separate accounts are maintained for each fund; however, in the accompanying financial statements, funds with similar characteristics have been combined into fund groups. Accordingly, all financial transactions have been recorded and reported by fund group.

Within each fund group, fund balances restricted by outside sources are so indicated and are distinguished from unrestricted funds which are allocated to specific purposes by the governing board. Externally restricted funds may be used only in accordance with the purposes established by the source of such funds and contrast with unrestricted funds over which the governing board retains full control to use in achieving any of its institutional purposes. Other allocations for fund balances include unemployment compensation, revolving accounts, unexpended gifts, and reappropriations. These were made in accordance with university policies.

All gains and losses arising from the sale, collection, or other disposition of investments and other noncash assets are accounted for in the fund that owned such assets. Ordinary income derived from investments, receivables, and the like is accounted for in the fund owning such assets, except for income derived from investments of endowment and similar funds. This income is accounted for in the fund to which it is restricted or, if unrestricted, as revenues in unrestricted current funds. All other unrestricted revenue is accounted for in the unrestricted current funds.

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Notes to the Financial Statements (Cont.)
June 30, 1999

Restricted gifts, grants, appropriations, endowment income, and other restricted resources are accounted for in the appropriate restricted funds. Restricted current funds are reported as revenues and expenditures when expended for current operating purposes.

Current Funds

Unrestricted current funds consist of those funds over which the university retains full control for use in achieving any of its authorized institutional purposes. Auxiliary enterprises activities are included in unrestricted current funds and include student housing, bookstores, food services, parking services, the men's athletic department at Knoxville, and certain other activities. Hospital activities are also included in unrestricted current funds. Restricted current funds are externally restricted and may be used only in accordance with the purposes established by their source.

Loan Funds

Loan funds consist of resources made available for student loans.

Endowment and Similar Funds

Endowment funds are subject to the restrictions of gift instruments requiring in perpetuity that the principal be invested and only the income be used. Although quasi-endowment funds have been established by the governing board for the same purpose as endowment funds, any portion of quasi-endowment funds may be expended. Since these funds are internally designated, the governing board retains the right to alter or amend such designation.

Annuity and Life Income Funds

Annuity and life income funds are funds held in trust by the university under agreement with donors whereby designated beneficiaries receive an annuity or specified interests in annual income of the trust. Upon death of the beneficiaries or other termination of the trust, such trust assets become available to the university for use as set forth in each agreement.

Plant Funds

The plant funds group consists of (1) unexpended plant funds, which are to be used for the construction or acquisition of physical properties for institutional purposes; (2) retirement of indebtedness and renewal and replacement funds, which are funds set aside for debt service charges and for the retirement of indebtedness on institutional properties, and major maintenance items on institutional properties, respectively; and

The University of Tennessee
Notes to the Financial Statements (Cont.)
June 30, 1999

(3) investment in plant funds, which are funds expended for, and thus invested in, institutional properties.

Agency Funds

The university acts solely as an agent in the handling of these funds; consequently, transactions of these funds do not affect the university's operating statements.

Inventories

Inventories are valued at cost, which is lower than market, based on the retail, specific identification, average cost, or first-in, first-out basis.

Investments

Investments in commercial paper are reported at amortized cost at June 30, 1999. All other investments are reported at fair value.

Investment in Plant

Physical plant, equipment, and land are stated at cost at date of purchase or at fair value at date of donation. Depreciation on the physical plant and equipment is not recorded. Purchases of library books and holdings are recorded as current fund expenditures and capitalized at standardized costs in the plant funds. Library books are valued at \$48 per volume and other library holdings are valued at various standardized values which approximate current costs. Livestock is valued at estimated market value. Equipment expenditures are capitalized when the unit acquisition cost is \$1,000 or greater and the estimated useful life is two years or more.

Capitalized Interest

The university capitalizes interest cost in excess of earnings on debt associated with capital projects as a component of buildings. Therefore, asset values in the investment in plant subgroup include such interest costs.

Accounts Payable

Included in unrestricted current funds - accounts payable are checks payable in the amount of \$12,485,812.83 as of June 30, 1999. These amounts represent the sum of checks written in excess of the university's checking account balance because of the use of a controlled disbursement account. In this way, the university maximizes interest income by transferring from an investment account only funds necessary to cover the checks that clear the bank daily.

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Notes to the Financial Statements (Cont.)
June 30, 1999

Accrued Compensated Absences

The university's employees accrue annual leave at varying rates, depending on length of service or classification. Some employees also earn compensatory time. Generally, all permanent full-time employees and certain part-time employees are entitled to accrue and carry forward calendar year maximums of 42 days annual vacation leave, except nine-month faculty members do not accrue annual leave. The amount reflects, as of June 30, all unused vacation leave payable upon termination. The liability is inventoried at fiscal year-end current salary costs and the cost of the salary-related benefit payments and is recorded in current funds. The net change in the liability is recorded in the current year in the applicable current funds functional expenditure categories. Since the liability is expected to be funded primarily from future unrestricted and restricted revenue sources, a related allocation has been made to the current fund balances so that these fund balances reflect current available funds.

Allocation for Working Capital

The unrestricted fund balance is allocated for the amount of working capital. "Working capital" is defined as the total of all petty cash, accounts receivable, inventories, and prepaid expenses in the unrestricted current fund at the balance sheet date, except for student receivables credited to deferred revenue, accrued interest, and amounts due on federal letters of credit, less the accrued benefits on accrued faculty salaries.

Income Taxes

The university, as a public corporation and an instrumentality of the State of Tennessee, is exempt from federal income taxes under Section 115 of the *Internal Revenue Code*. Contributions to the university are deductible by donors as provided under Section 170 of the *Internal Revenue Code*.

Tennessee State School Bond Authority Debt Proceeds Receivable

Tennessee State School Bond Authority Debt Proceeds Receivable in unexpended plant consist of Tennessee State School Bond Authority debt issued for which the proceeds have not yet been received.

Totals (Memorandum Only)

Total columns on the general-purpose financial statements are captioned "memorandum only" to indicate that they are presented only to facilitate financial analysis. Data in these columns do not present financial position or results of operations in conformity with generally accepted accounting principles. Neither are

The University of Tennessee
Notes to the Financial Statements (Cont.)
June 30, 1999

such data comparable to a consolidation. Interfund eliminations have not been made in the aggregation of this data.

NOTE 2. DEPOSITS AND INVESTMENTS

Investment Policy

The University of Tennessee maintains a cash management investment pool that is available for use by all fund groups. State statutes and university investment policies authorize the university's cash management pool to invest in collateralized Tennessee bank or savings and loan association certificates of deposit, U.S. Treasury obligations, U.S. government agency obligations, repurchase agreements of those securities, highest quality commercial paper, prime bankers' acceptances, and money market mutual funds meeting certain criteria.

In accordance with state statutes, commercial banks and savings and loan associations that do not participate in the State of Tennessee Collateral Pool for Public Deposits must pledge securities with third parties as collateral to secure university time and demand deposits. Market values of these securities are regularly monitored to ascertain that 105% of university deposits, less the amounts protected by the Federal Deposit Insurance Corporation, are secured.

There are two categories of university funds which are subject to long-term investment: the endowment and similar funds and the annuity and life income funds. The investment of these funds is governed by the gift instrument and the investment policies established by the Board of Trustees. For a more complete description of these investments, please refer to Note 3, "Endowment and Similar Funds and Annuity and Life Income Funds."

Cash and Cash Equivalents

In addition to petty cash and demand deposits, this classification includes instruments which are readily convertible to known amounts of cash. At June 30, 1999, cash and cash equivalents consisted of \$7,668,862.81 in bank accounts, \$1,552,117.00 of petty cash on hand, \$3,010,000.00 of certificates of deposit, and \$328,235,462.77 in the university's cash management investment pool. Additionally, the university maintains custodial accounts at First Tennessee Bank for funds contractually managed by independent investment counsel. In accordance with the custody agreement, First Tennessee Bank placed cash equivalents of \$4,878,300.82 at June 30, 1999, in the bank's money market mutual fund.

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Notes to the Financial Statements (Cont.)
June 30, 1999

Deposits

Deposits with financial institutions are required to be categorized to indicate the level of custodial risk assumed by the university. Category 1 consists of deposits that are insured or collateralized with securities held by the university or by its agent in the university's name. Category 2 consists of deposits collateralized with securities held by the pledging financial institution's trust department or agent in the university's name. Category 3 deposits are uncollateralized. This category includes any bank balance that is collateralized with securities held by the pledging financial institution or by its trust department or agent but not in the university's name.

Some of the university's bank accounts are in financial institutions which participate in the bank collateral pool administered by the Treasurer of the State of Tennessee. The securities pledged to protect these accounts are pledged in the aggregate rather than against each individual account. The members of the pool may be required by agreement to pay an assessment to cover any deficiency. Under this additional assessment agreement, public fund accounts covered by the pool are considered to be insured for purposes of credit risk disclosure.

At June 30, 1999, the carrying amount of the university's deposits was \$10,678,862.81, and the bank balance including accrued interest was \$13,384,031.57. The entire bank balance was category 1.

During the year ended June 30, 1999, the university had uncollateralized deposits on several days, ranging from \$1,051.50 to \$4,913,394.27.

The laws of the State of Tennessee require that collateral be pledged to secure all uninsured deposits.

Cash Management Investment Pool

The cash management investment pool consists of marketable securities and government repurchase agreements as previously described. The reported amount of the cash management pool at June 30, 1999, was \$328,235,462.77. The cost of the cash management pool at June 30, 1999, was \$328,502,502.10. The reported amount of securities in the pool with a maturity date of three months or less from the date of purchase at June 30, 1999, was \$63,674,627.23. The cost of these same securities at June 30, 1999, was \$63,358,235.83. The securities in the pool are categorized on the following page, listed as cash equivalents, to indicate the level of risk assumed by the university. The university's standard "Master Repurchase Agreements" require that the securities underlying repurchase agreements have fair value equal to or exceeding

The University of Tennessee
Notes to the Financial Statements (Cont.)
June 30, 1999

100% of the cost of the repurchase agreement and be delivered to its agent's trust account at the Federal Reserve Bank - Memphis. The fair value of securities underlying repurchase agreements was \$21,525,525.38 at June 30, 1999.

Investments

The university's investments are categorized below to indicate the level of custodial risk assumed by the university at year end. Category 1 consists of insured or registered investments or investments for which the securities are held by the university or its agent in the university's name. Category 2 consists of uninsured or unregistered investments for which the securities are held by the counterparty's trust department or agent in the university's name. Category 3 consists of uninsured and unregistered investments for which the securities are held by the counterparty or by its trust department or agent but not in the university's name.

June 30, 1999

	Category			Reported	Cost
	1	2	3	Amount	
Cash equivalents					
Government securities	\$ 198,058,720.96	\$ -	\$ -	\$ 198,058,720.96	\$ 198,994,427.66
Repurchase agreements	21,000,000.00	-	-	21,000,000.00	21,000,000.00
Commercial paper	<u>109,176,741.81</u>	<u>-</u>	<u>-</u>	<u>109,176,741.81</u>	<u>108,508,074.44</u>
	<u>328,235,462.77</u>	<u>-</u>	<u>-</u>	<u>328,235,462.77</u>	<u>328,502,502.10</u>
Investments					
Domestic securities					
Government securities	15,623,925.04	38,674,942.54	-	54,298,867.58	54,033,767.65
Corporate bonds	3,013,088.39	30,711,314.30	-	33,724,402.69	33,972,175.57
Corporate stocks	123,683,196.01	8,313,919.67	-	131,997,115.68	108,344,774.58
Mortgages and notes	2,444,969.74	-	-	2,444,969.74	2,398,848.84
Other investments	195,384.15	-	-	195,384.15	190,573.28
International securities					
Corporate stocks	2,584,250.00	-	-	2,584,250.00	2,787,215.91
Assets with trustees	-	-	4,999,778.97	4,999,778.97	3,395,794.18
Assets with UHS					
Ventures	<u>-</u>	<u>-</u>	<u>6,679,250.23</u>	<u>6,679,250.23</u>	<u>6,679,250.23</u>
	<u>147,544,813.33</u>	<u>77,700,176.51</u>	<u>11,679,029.20</u>	<u>236,924,019.04</u>	<u>211,802,400.24</u>
	<u>\$ 475,780,276.10</u>	<u>\$ 77,700,176.51</u>	<u>\$ 11,679,029.20</u>		

University cash equivalents and investments not susceptible to categorization:

Cash equivalents - assets with First Tennessee Bank as custodian	4,878,300.82	4,878,300.82
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The University of Tennessee
Notes to the Financial Statements (Cont.)
June 30, 1999

Limited partnership-venture capital funds	21,811,907.07	17,474,898.47
Mutual funds	155,393,472.34	124,935,423.0
Real estate equity funds	17,976,518.82	17,930,152.12
Real estate gifts	<u>7,005,927.79</u>	<u>7,191,855.45</u>
Total investments and cash equivalents	772,225,608.65	712,715,532.2
Less: Cash equivalents	<u>333,113,763.59</u>	<u>333,380,802.9</u>
Total investments and assets with others	<u>\$ 439,111,845.06</u>	<u>\$ 379,334,729.3</u>

Assets with trustees of \$132,101.66 at June 30, 1999, in retirement of indebtedness consisted of securities held in debt service reserve with First Tennessee Bank. Assets with trustees of \$638,453.44 at June 30, 1999, in retirement of indebtedness consisted of securities in an interest rate reserve fund with the Tennessee State School Bond Authority.

NOTE 3. ENDOWMENT AND SIMILAR FUNDS AND ANNUITY AND LIFE INCOME FUNDS

There are two categories of university funds which are subject to long-term investment: the endowment and similar funds and the annuity and life income funds. The investment of these funds is governed by the gift instrument and the investment policies established by the Board of Trustees.

Effective July 1, 1954, the university adopted the policy of investing endowment and similar funds over which it had full investment discretion (and on which the donor or governing gift instrument does not require separate investment) in the Consolidated Investment Pool. This pooling of investments affords closer supervision of the investment portfolio and provides, regardless of size, the advantages of participation in a well-diversified portfolio of investments. All contributing endowments participate in the income and capital appreciation of the Pool on a per-share basis commensurate with its contribution to the Pool. New endowment funds purchase shares in the Pool at the end of each month at the current fair value per share, determined by valuing the Pool at month end fair value and dividing by the number of units outstanding. Net realized capital gains are reinvested and may be used for any shortfall between current income and spending plan distributions. The spending plan provides distributions equal to 5% of a three-year moving average Pool fair value determined as of December 31. The per unit fair value for participating endowments was \$3.663266 at June 30, 1999. Income distributed was \$.14492 per share in 1999 or \$13,826,512.46. All endowment and similar funds not invested as part of the Consolidated Investment Pool are separately

The University of Tennessee
Notes to the Financial Statements (Cont.)
June 30, 1999

invested to observe requirements or limitations imposed by donors. Income earned and distributed on separately invested endowment and similar funds amounted to \$621,732.13 for 1999.

Annuity and life income funds are separately invested entities requiring detailed accounting to reflect specific compliance with terms of each trust and applicable federal regulations. The investment objectives as reflected in each agreement vary widely since they are affected by the age, income level, and needs of the beneficiaries as well as motives and objectives of the donors. Interest, dividend, rent, and royalty income realized on these funds for 1999 amounted to \$2,396,287.33.

The fair value of endowment and similar funds at June 30, 1999, was \$379,169,716.87 and the cost was \$325,124,809.25. The fair value of annuity and life income funds at June 30, 1999, was \$55,201,106.75 and cost was \$51,296,474.87.

NOTE 4. TSSBA INDEBTEDNESS AND NOTES PAYABLE

Tennessee State School Bond Authority (TSSBA) bonds, with interest rates ranging from 3.0% to 9.0%, are due serially to 2028 and are secured by pledges of the facilities' revenue to which they relate and certain other revenues and fees of the university, including state appropriations. The total outstanding bonded indebtedness for the university was \$213,239,464.13 at June 30, 1999. The total bonded indebtedness reported on the balance sheet at June 30, 1999, is shown net of unaccreted bonds payable of \$8,454,600.36 and assets of \$16,382,244.50 held by the Tennessee State School Bond Authority.

Included in the total outstanding indebtedness is a \$242,000.00 note with the Department of Education, which was issued in March 1989. The note carries an interest rate of 3% and is due semi-annually to 2003. The outstanding balance of the note payable at June 30, 1999, was \$70,259.50.

The university's debt service requirements to maturity for all bonds and the Department of Education note payable at June 30 are as follows:

	<u>Principal</u>	<u>Interest</u>
2000	\$ 12,784,881.38	\$ 9,702,498.98
2001	13,083,263.43	9,243,020.00
2002	13,631,326.61	8,721,001.55

The University of Tennessee
Notes to the Financial Statements (Cont.)
June 30, 1999

2003	13,789,075.31	8,150,304.65
2004	14,064,856.46	7,566,351.15
Subsequent Years	145,956,320.4	62,812,783.73
	4	_____
	\$ 213,309,723.6	\$ 106,195,960.06
	3	=====

Commercial Paper Program

The Tennessee State School Bond Authority authorized the issuance of commercial paper on November 18, 1997, to finance costs of various capital projects. The commercial paper also refinanced certain outstanding bond anticipation note indebtedness that the authority had previously issued to finance costs of various capital projects. At June 30, 1999, \$117,720,090.70 had been issued for projects at the University of Tennessee.

The University of Tennessee contributes funds to the Interest Rate Reserve Fund equal to \$4.46 per thousand drawn in the tax-exempt program and \$6.16 per thousand drawn in the taxable program. A contribution is required each time an additional draw is made from the program. The principal of the reserve will be contributed to pay off the commercial paper or credited back to the institution when the commercial paper is converted to bonds. The interest earned on the reserve is used to pay interest due during the month. The commercial paper bears interest at a variable rate, which is paid monthly. The maturity of the paper may not exceed 270 days and the maximum interest rate may not exceed 12%. Upon maturity, the paper is redeemed or extinguished with long-term debt.

The total indebtedness of the university at June 30, 1999, was \$331,029,814.33.

NOTE 5. OPERATING LEASES

The university has entered into various operating leases for buildings and equipment. It is expected that in the normal course of business such leases will continue to be required. Net expenditures for rentals under leases for the year ended June 30, 1999, amounted to \$7,123,703.39.

The University of Tennessee
Notes to the Financial Statements (Cont.)
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The following is a schedule of future minimum rental payments required under noncancelable operating leases that have initial or remaining lease terms of more than one year at June 30, 1999.

Year Ending <u>June 30</u>	
2000	\$ 701,222.25
2001	669,572.25
2002	599,910.16
2003	348,758.00
2004	9,110.00
Later Years	<u>81,990.00</u>
Total Minimum Payments Required	<u><u>\$2,410,562.66</u></u>

NOTE 6. CAPITAL LEASES

The university leases certain items of equipment which are classified as capital leases. These agreements have beginning and ending dates ranging from February 1997 to January 2001 and imputed interest rates ranging from 5.75% to 6.55%. Future minimum lease payments under capital leases together with the present value of the net minimum lease payments at June 30, 1999, are as follows:

Year Ending <u>June 30</u>	
2000	\$ 731,515.20
2001	<u>395,492.65</u>
Total minimum lease payments	1,127,007.85
Less amounts representing interest	<u>57,228.34</u>
Present value of net minimum lease payments	<u><u>\$1,069,779.51</u></u>

The University of Tennessee
Notes to the Financial Statements (Cont.)
June 30, 1999

The total value of equipment capitalized under lease obligations was \$2,310,071.34 at June 30, 1999.

NOTE 7. INSURANCE-RELATED ACTIVITIES

Risk Management

The university is exposed to various risks of loss related to general liability; automobile liability; professional malpractice; workers' compensation; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters.

- a. The university carries commercial insurance for losses related to hired and nonowned automobiles, losses related to railroad protection, and losses related to ten university-owned aircraft. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.
- b. The state purchases commercial insurance for real property losses above \$5 million per year and surety bond coverage on the state's officials and employees. In the past three fiscal years, the state has not had any claims filed with the commercial insurer. A designation for casualty losses in the amount of \$5 million has been established in the state's general fund to provide for any property losses other than the commercial insurance coverage. At June 30, 1999, the scheduled coverage for the university was \$2,305,215,700 for buildings and \$829,963,900 for contents.
- c. The state has set aside assets for claim settlement in an internal service fund, the Claims Award Fund. This fund services all claims for risk of loss to which the state is exposed, including general liability, automobile liability, professional malpractice, and workers' compensation. The university participates in the Claims Award Fund. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the university based on a percentage of the university's expected loss costs, which include both experience and exposures. This charge considers recent trends in actual claims experience of the state as a whole. An actuarial valuation is performed as of fiscal year-end to determine the fund liability and premium allocation. Since the university

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Notes to the Financial Statements (Cont.)
June 30, 1999

participates in the Claims Award Fund, it is subject to the liability limitations under the provisions of the Tennessee Claims Commission Act, *Tennessee Code Annotated*, Section 9-8-101 et seq. Liability for negligence of the university for bodily injury and property damage is limited to \$300,000 per person and \$1,000,000 per occurrence. The limits of liability under workers' compensation are set forth in *Tennessee Code Annotated*, Section 50-6-101 et seq. Claims are paid through the state's Claims Award Fund. The premium assessed to the university by the Claims Award Fund for the period July 1, 1998, through June 30, 1999, was \$1,570,200.

The state has also set aside assets in the Employee Group Insurance Fund, an internal service fund, to provide a program of health insurance coverage for the employees of the state with the risk retained by the state. All full-time and some part-time university employees are eligible to participate in the Employee Group Insurance Fund. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the university based on estimates of the ultimate cost of claims that have been reported but not settled and of claims that have been incurred but not reported. Employees and providers have 13 months to file medical claims. The university pays approximately 80% of the cost of insurance, and the employee pays the remaining 20%. All assets, liabilities, and payments are administered by the state. At June 30, 1999, 12,417 university employees were enrolled in the basic plan or Health Maintenance Organization.

NOTE 8. PENSION PLANS

Defined Benefit Plans

Tennessee Consolidated Retirement System

Plan Description

The University of Tennessee contributes to the State Employees, Teachers, and Higher Education Employees Pension Plan (SETHEEPP), a cost-sharing multiple-employer defined benefit pension plan administered by the Tennessee Consolidated Retirement System (TCRS). TCRS provides retirement, death, and disability benefits as well as annual cost-of-living adjustments to plan members and their beneficiaries. Title 8, Chapters 34-37, *Tennessee Code Annotated*, establishes benefit provisions. State statutes are amended by the Tennessee General Assembly. The TCRS issues a publicly available financial report that includes financial statements and required supplementary information for SETHEEPP. That report may be obtained by writing to the Tennessee

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Department of the Treasury, Consolidated Retirement System, 10th Floor Andrew Jackson Building, Nashville, Tennessee, 37243-0230 or by calling (615) 741-8202.

Funding Policy

Plan members are noncontributory. The university is required to contribute at an actuarially determined rate. The current rate is 5.43% of annual covered payroll. The contribution requirements of the plan members are established by state statute. Contribution requirements for the university are established and may be amended by the TCRS' Board of Trustees. The university's contributions to TCRS for the years ended June 30, 1999, 1998, and 1997 were \$12,482,257.13, \$8,249,822.51, and \$16,639,419.22. Those contributions met the required contributions for each year.

Federal Retirement Program

Plan Description

The University of Tennessee contributes to the Federal Retirement Program, a cost-sharing multiple-employer defined benefit pension plan administered by the Civil Service Retirement System (CSRS) for participants employed prior to January 1, 1984, and the Federal Employees Retirement System (FERS) for participants employed after December 31, 1983. Both systems provide retirement, death, and disability benefits, as well as annual cost-of-living adjustments, to plan members and their beneficiaries. All regular full-time employees of the University of Tennessee Agricultural Extension Service who hold federal appointments for 51% or more of their time are required to participate in either one of the two Federal Retirement Programs. For both systems, benefit provisions are established in federal statutes. Federal statutes are amended by the U.S. Congress.

CSRS and FERS issue publicly available financial reports that include financial statements and required supplementary information. These reports may be obtained by writing to the Office of Personnel Management, Retirement Information Office, P.O. Box 45, Boyers, PA 16017-0045, or by calling (202) 606-0500.

Funding Policy

Participating employees, with some exceptions, are required by federal statute to contribute 7.25% of covered salaries to the CSRS plan. The university is required to contribute 8.51%. Contribution requirements are established and may be amended by

The University of Tennessee
Notes to the Financial Statements (Cont.)
June 30, 1999

federal statute. Contributions to CSRS for the year ended June 30, 1999, were \$1,858,184.24, which consisted of \$1,033,656.58 from the university and \$824,527.66 from the employees; contributions for the year ended June 30, 1998, were \$1,807,425.56, which consisted of \$993,182.54 from the university and \$814,243.02 from the employees; and contributions for the year ended June 30, 1997, were \$1,750,892.38, which consisted of \$895,705.03 from the university and \$855,187.35 from the employees.

Federal statute requires employees participating in FERS to contribute 1.05% of their salaries to the Basic Benefit Plan. The university is required to contribute 10.7%. In addition, the university is required to contribute 1% of each participant's salary to the Thrift Savings Plan plus up to an additional 4% depending upon employees' contributions, which can range from 0 to 10% of their salaries. Contributions for the Basic Benefit Plan were \$947,581.70 for the year ended June 30, 1999, which consisted of \$75,606.59 from employees and \$871,975.11 from the university; \$884,560.16 for the year ended June 30, 1998, which consisted of \$60,638.43 from employees and \$823,921.73 from the university; and \$884,462.66 for the year ended June 30, 1997, which consisted of \$57,995.03 from employees and \$826,467.63 from the university. Contributions for the Thrift Savings Plan were \$837,473.64 for the year ended June 30, 1999, which consisted of \$521,089.00 from employees and \$316,384.64 from the university; \$747,733.09 for the year ended June 30, 1998, which consisted of \$466,120.97 from employees and \$281,612.12 from the university; and \$708,032.14 for the year ended June 30, 1997, which consisted of \$441,178.00 from employees and \$266,854.14 from the university. Contributions met the requirements for each year.

Defined Contribution Plans

Optional Retirement Plans (ORP)

The university contributes to three defined contribution plans: Teachers Insurance and Annuity Association-College Retirement Equities Fund (TIAA-CREF), Aetna Life Insurance and Annuity Company, and Variable Annuity Life Insurance Company (VALIC). These plans are administered by the Tennessee Department of the Treasury. Each plan provides retirement benefits to faculty and staff who are exempt from the overtime provisions of the Fair Labor Standards Act and who waive membership in TCRS. Benefits depend solely on amounts contributed to the plan plus investment earnings. Plan provisions are established by state statute in Title 8, Chapter 35, Part 4, *Tennessee Code Annotated*. State statutes are amended by the Tennessee General Assembly.

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Notes to the Financial Statements (Cont.)
June 30, 1999

Plan members are noncontributory. The university contributes an amount equal to 10% of the employee's base salary below the social security wage base and 11% above the social security wage base. Contribution requirements are established and amended by state statute. The contribution made by the university to the plans for the year ended June 30, 1999, was \$31,199,221.93, and for the year ended June 30, 1998, was \$29,914,649.67. Contributions met the requirements for each year.

Joint Contributory Retirement System Plan A-JCRS-A

The Joint Contributory Retirement System Plan A (JCRS-A) is a defined contribution plan with minimum benefits and is administered by the Tennessee Consolidated Retirement System and TIAA-CREF. Employees who were enrolled in the Teachers Insurance and Annuity Association-College Retirement Equities Fund (TIAA-CREF) before July 1977 are members of JCRS-A. Enrollment in this plan for new employees has been closed since July 1977. Although JCRS-A members participate in Aetna, TIAA-CREF, or VALIC, they may also, under certain circumstances, receive a supplementary benefit from the State of Tennessee. Plan provisions are established by *Tennessee Code Annotated*, Chapter 35, Part 4. State statutes are amended by the Tennessee General Assembly.

Plan members are noncontributory. The university's contributions for JCRS-A members were calculated using the base salary amounts of \$66,771,188.51 for fiscal year 1999. Contribution requirements are established and amended by state statute. The contributions are included in the ORP amounts. University contributions to fund the state supplemental benefit totaled \$3,615,516.66 in fiscal year 1999, and \$2,497,251.38 in fiscal year 1998. Contributions met the requirements for each year.

Deferred Compensation Plans

The University of Tennessee offers its employees three deferred compensation plans. The university, through the State of Tennessee, provides two plans, one established pursuant to *Internal Revenue Code (IRC)*, Section 457, and the other pursuant to *IRC*, Section 401(k). The third plan is administered by the university and was established in accordance with *IRC*, Section 403(b). These plans, available to all university employees, permit them to defer a portion of their salaries to future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency. All costs of administering and funding these plans, with the exclusion of the \$20 monthly university match for the Section 401(k) plan, are the responsibility of plan participants.

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Notes to the Financial Statements (Cont.)
June 30, 1999

Since Section 457 and 401(k) plan assets remain the property of the contributing employees, they are not presented in the State of Tennessee financial statements. Effective January 1996, the university began providing a \$20 monthly match from unrestricted current funds for employees making a minimum monthly contribution of \$20 to the Section 401(k) plan. During the year ended June 30, 1999, contributions totaling \$7,349,476.21 were made by employees participating in the plan, with a related match of \$1,727,752.00 made by the university. In accordance with the *IRC*, employee contributions through the 403(b) plan remain the assets of the employee; therefore, these employee contributions are not reflected in the university's financial statements.

OTHER POST-EMPLOYMENT BENEFITS

Health Care

The State of Tennessee administers a group health insurance program which provides post-employment health insurance benefits to eligible university retirees. This benefit is provided by and administered by the State of Tennessee. The university assumes no liability for retiree health care programs. Information related to this plan is available at the statewide level in the *Tennessee Comprehensive Annual Financial Report*.

NOTE 9. AFFILIATED ENTITIES

The University of Chattanooga Foundation, Inc., a private, nonprofit corporation, maintains an endowment fund of which the University of Tennessee at Chattanooga is the sole income beneficiary. The financial records, investments, and other financial transactions are not managed by the university and accordingly are not included in these financial statements except for certain endowment assets. During the year ended June 30, 1999, the foundation transferred \$2,977,405.00 to the university for support of designated projects at the Chattanooga campus. In addition, \$347,162.94 was expended in 1999 directly by the foundation for the benefit of the University of Tennessee at Chattanooga.

Since fiscal year 1985, the Tennessee General Assembly has appropriated \$22 million to a Chairs of Excellence Endowment for the University of Tennessee. The appropriations provided that the Chairs of Excellence Endowment be established as an irrevocable trust with the state treasurer and required the university to match the appropriation on a dollar-for-dollar basis. The university has fully matched 49 chairs as of June 30, 1999. The financial statements of the university include as restricted

The University of Tennessee
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June 30, 1999

expenditures the amounts expended in the current year to match the state appropriations. The university's balance sheet does not include the amounts held in trust by the state treasurer. At June 30, 1999, the amounts held in trust totaled \$108,339,711.54, at fair value.

NOTE 10. CONTINGENCIES AND COMMITMENTS

Construction Commitment

The university has contractual obligations for the construction of new buildings and additions to and renovations of existing buildings. The outstanding commitments under such contracts at June 30, 1999, were \$33,245,683.39. At June 30, 1999, amounts due from or receivable from the state totaled \$99,371,873.61, and amounts due from or receivable from the School Bond Authority for capital construction, renovations, and maintenance totaled \$2,332,245.83.

Construction in Progress

Construction in progress is included in structures and improvements in investment in plant. Forty-two projects were under construction at June 30, 1999. Construction in progress totaled \$77,154,662.15 at June 30, 1999.

Encumbrances

Encumbrances, which represent commitments of prior-year funds for goods that have been ordered but not delivered or services that have not been rendered as of June 30, 1999, are recorded as an allocation of the current fund balances. The allocation for encumbrances at June 30, 1999, was \$9,014,160.92.

Sick Leave

The university records the cost of sick leave when paid. Generally, since sick leave (earned one day per month with unlimited accumulation) is paid only when an employee dies or is absent due to illness, or injury, there is no liability for sick leave at June 30, 1999. The amount of unused sick leave at June 30, 1999, was \$165,397,838.94.

Grants and Contracts

The university receives grants and contracts from various federal and state agencies to fund research and other activities. The costs, both direct and indirect, charged to these grants and contracts are subject to audit and disallowance by the granting agency. The

The University of Tennessee
Notes to the Financial Statements (Cont.)
June 30, 1999

university administration believes that any disallowance or adjustments would not have a material effect on the university's financial position.

Nonvested Equipment

Equipment in the possession of the university valued at \$8,043,947.86 as of June 30, 1999, is not reflected in the financial statements. This equipment was purchased with restricted grant and contract funds and other funds, and title has not yet transferred to the university.

Litigation

The university is involved in several lawsuits, none of which are expected to have a material effect on the financial position of the university.

NOTE 11. PLEDGES

Pledges totaling \$34,592,179.93, restricted to instruction, research, public service, library, operation and maintenance of physical plant, student aid, property, buildings, equipment, endowment, loans, and other restricted purposes, are due to be collected as follows:

<u>Fiscal Year</u>	
1999-2000	\$11,660,491.05
2000-01	6,772,985.79
2001-02	6,002,686.33
2002-03	4,569,191.97
2003-04	3,047,148.89
Subsequent Years	<u>2,539,675.90</u>
	<u><u>\$34,592,179.93</u></u>

It is not practicable to estimate the net realizable value of such pledges, and therefore, they are not reflected in the accompanying financial statements.

NOTE 12. PRIOR PERIOD RESTATEMENTS

The University of Tennessee
Notes to the Financial Statements (Cont.)
June 30, 1999

For the year ended June 30, 1999, the university changed its method of accounting to reflect annuities payable in the annuity and life income funds. The university had previously reported these liabilities in the life income fund balance. The cumulative effect of this correction is reported in the accompanying financial statements as an increase in annuities payable and a decrease in beginning annuity and life income fund balance of \$6,955,285.56. In addition, the university changed its method of accounting to reflect certain quasi-endowment fund balances as restricted funds. The cumulative effect of this correction is reported in the accompanying financial statements as an increase to the quasi-endowment restricted fund balance and a decrease in the quasi-endowment unrestricted fund balance of \$14,186,937.60. The university also changed its method of accounting to reclassify certain restricted unexpended plant fund balances as unrestricted funds. The cumulative effect of this correction is reported in the accompanying financial statements as an increase to the plant fund - unrestricted fund balance and a decrease in the plant fund - restricted fund balance of \$556,394.45. The beginning fund balances were appropriately adjusted on the June 30, 1999, Statement of Changes in Fund Balances.

The university has changed its method of classifying governmental grants and contracts. The fundor level is now reported based upon the level of the agency that makes the decision that the moneys will be used for a particular purpose for which they ultimately are expended and not necessarily the agency from which the moneys are received. As a result, state grants and contracts of \$16,711,138.53 for the year ended June 30, 1998, have been reclassified as federal grants and contracts on the Statement of Current Funds Revenues, Expenditures, and Other Changes.

NOTE 13. SUBSEQUENT EVENTS

UHS Ventures, Inc.

On July 16, 1999, the university transferred its sole membership in UHS Ventures, Inc., a component unit formerly known as University Health System, Inc., to a newly formed 501(c)(3) corporation also named University Health System, Inc. The new corporation was formed in order to operate the UT Memorial Research Center and Hospital as described below. Therefore, UHS Ventures, Inc., will no longer be a component unit of the university.

UT Memorial Research Center and Hospital

On July 29, 1999, the university transferred operation, management, and control of its hospital located in Knoxville to University Health Systems, Inc., (UHS) an

The University of Tennessee
Notes to the Financial Statements (Cont.)
June 30, 1999

independent, private, not-for-profit organization operating under its own 501C(3) designation. The transfer of the hospital from the university to UHS was accomplished through three main agreements: the Lease and Transfer Agreement, the Employee Service Agreement, and the Affiliation Agreement. Each of these agreements is summarized below.

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Notes to the Financial Statements (Cont.)
June 30, 1999

Lease and Transfer Agreement

Pursuant to the enabling legislation, *Tennessee Code Annotated*, Section 49-9-112 and Section 49-9-1301 et. seq., UHS leased from the university the real property and buildings of the existing hospital and Graduate School of Medicine. UHS also executed a five-year lease for office space at the university's Henley Street facility at fair market value. The university transferred to UHS all operating assets of the hospital. The term of the lease is 50 years. The consideration for the lease of the facilities and transfer of the operating assets is payment by UHS of a) a sum sufficient to economically defease all of the debt issued by the Tennessee State School Bond Authority in the amount of \$149,967,989.67, b) \$25,000,000.00 paid to the university at closing, and c) a variable lease obligation of at least \$50,000,000.00 to be paid to the university over 20 years. UHS assumes all prior hospital liabilities, known or unknown.

Employee Service Agreement

UHS will lease from the university all employees of the hospital prior to the closing on July 29, 1999. UHS shall pay to the university the amounts incurred by the university to pay the direct expenses relating to the leased hospital employees, including wages, salaries, and benefits. The term of the Employee Service Agreement is 50 years. All persons who begin service at the hospital after the date the employee service agreement is signed will be employees of UHS and not university employees.

Affiliation Agreement

The university and UHS agreed that UHS will continue to support the Graduate School of Medicine by providing appropriate facilities and resources of the hospital to the faculty and students at the Graduate School of Medicine. UHS agrees to pay the university \$1,500,000 at closing for the benefit of the Graduate School of Medicine. UHS must pay monthly to the university for the benefit of the Graduate School of Medicine the government funding, direct and indirect medical education funds, TennCare medical education funds, and other medical education funds received by UHS for the benefit of the Graduate School of Medicine. The amount payable by UHS shall be reduced by a) the fair market rental value of the space provided to the Graduate School of Medicine; b) the fair market value of the information system, telecommunication, network infrastructure, and human resource services provided by UHS to the Graduate School of Medicine; and c) retroactive adjustments made by payors to the graduate medical education payments.

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June 30, 1999

NOTE 14. COMPONENT UNIT CONDENSED FINANCIAL STATEMENTS

The financial statements include a discrete presentation of the assets, liabilities, fund balances, revenues, and expenses of UHS Ventures, Inc., (formerly known as University Health System, Inc.) for the year ended December 31, 1998. This information is also presented below, along with the corporation's Statement of Cash Flows.

BALANCE SHEET

	<u>December 31,</u> <u>1998</u>
<u>ASSETS</u>	
Amounts receivable from the university	\$ 1,195,707
Other current assets	7,300,738
Other assets	<u>3,100,288</u>
 TOTAL ASSETS	 \$ <u><u>11,596,733</u></u>
<u>LIABILITIES AND NET WORTH</u>	
Current liabilities due to the university	\$ 480,150
Funds held in trust for the university	4,950,848
Other current liabilities	1,885,886
Net worth	<u>4,279,849</u>
 TOTAL LIABILITIES AND NET WORTH	 \$ <u><u>11,596,733</u></u>

See notes to financial statements.

STATEMENT OF REVENUES AND EXPENSES

	<u>1998</u>
<u>REVENUES</u>	
University related revenues	\$ 3,335,624
Other revenues	<u>3,933,186</u>
TOTAL REVENUES	<u><u>7,268,810</u></u>

The University of Tennessee
Notes to the Financial Statements (Cont.)
June 30, 1999

<u>EXPENSES</u>	
University related	291,654
Depreciation	123,695
Other	5,407,730
TOTAL EXPENSES	<u>5,823,079</u>
 NET INCOME	 \$ <u><u>1,445,731</u></u>

See notes to financial statements.

STATEMENT OF CASH FLOWS

	<u>1998</u>
Cash flows from operating activities:	
Net income	\$ 1,445,731
Adjustments to reconcile net income to net cash provided by operating activities:	
Depreciation and amortization	177,950
Equity in income of affiliate	(1,399,162)
Increase in receivables	(490,822)
Increase in prepaid expenses	(78,852)
Increase in deferred tax benefits	(16,380)
Increase in accounts payable and accrued expenses	989,574
Decrease in deferred revenue	(286,748)
Increase in income taxes payable	<u>39,022</u>
Net cash provided by operating activities	<u>380,313</u>
 Cash flows from investing activities:	
Additions to property and equipment	<u>(263,326)</u>
Net cash used in investing activities	<u>(263,326)</u>
 Cash flows from financing activities:	
Cash received for University of Tennessee Medical Center	25,294,915
Cash disbursed for University of Tennessee Medical Center	<u>(23,850,404)</u>

The University of Tennessee
Notes to the Financial Statements (Cont.)
June 30, 1999

Net cash provided by financing activities	<u>1,444,511</u>
Net increase in cash and cash equivalents	1,561,498
Cash and cash equivalents at beginning of year	<u>4,519,390</u>
Cash and cash equivalents at end of year	\$ <u><u>6,080,888</u></u>

See notes to financial statements.

Summary of Significant Accounting Policies

Basis of financial statement presentation

The financial statements for UHS Ventures, Inc., (formerly known as University Health System, Inc.) are prepared in accordance with generally accepted accounting principles as prescribed by the Financial Accounting Standards Board. The financial statements include the accounts of the corporation and its wholly owned subsidiary, Managed Care Ventures I, Inc. Intercompany transactions and accounts have been eliminated in the financial statements.

Nature of Business

UHS Ventures, Inc., was formed on January 1, 1996, for the purpose of providing practice management and other administrative services to physician groups, physician associations, and the University of Tennessee Medical Center at Knoxville. Substantially all of the corporation's revenues and resulting receivables are derived from these services which are provided to organizations located in East Tennessee.

Related Parties

UHS Ventures, Inc., is wholly owned by the University of Tennessee and is affiliated through a brother/sister relationship with the University of Tennessee Medical Center at Knoxville. UHS Ventures, Inc., provides administrative services to the University of Tennessee Medical Center. The contractual services amounted to \$375,252 in 1998.

UHS Ventures, Inc., owns 100% of Managed Care Ventures I, Inc., which in turns owns 50% of Tennessee Health Partnership. In addition, UHS Ventures, Inc.,

The University of Tennessee
Notes to the Financial Statements (Cont.)
June 30, 1999

provides administrative services for University Physicians Association. The Association paid UHS Ventures, Inc., \$536,906 in 1998 for administrative services. The principal source of revenue for University Physicians Association is a capitated health care contract with Tennessee Health Partnership.

Investment in Affiliated Company

The corporation owns 50% of Tennessee Health Partnership and accounts for the investment using the equity method. The corporation's investment is increased for contributions to capital and its respective share of the investee's earnings. The investment is decreased for dividends received and the corporation's respective share of losses. The carrying value of the investment approximates the related equity in the net assets of the investee. The summary financial information is excerpted from audited financial statements.

Balance Sheet	1998
Current assets	\$ 25,706,751
Other assets	132,603
Property and equipment	<u>1,806,638</u>
	\$ <u><u>27,645,992</u></u>
Current liabilities	\$ 22,438,936
Other liabilities	133,278
Partner's capital	<u>5,073,778</u>
	\$ <u><u>27,645,992</u></u>
Results of Operations	
Revenue	\$ 146,781,812
Less:	
Expenses	142,325,162
Income taxes	<u>1,658,332</u>
Net Income	\$ <u><u>2,798,318</u></u>

The University of Tennessee Required Supplementary Information Year 2000 Disclosures

The Year 2000 (Y2K) Issue arises because most computer software programs allocate two digits to the data field for year on the assumption that the first two digits will be 19. Such programs will thus interpret the year 2000 as the year 1900, the year 2001 as 1901, etc., absent reprogramming. Y2K affects both computer hardware (i.e., the embedded logic of computer chips) and computer software, and could affect both the ability to enter data into computer programs and the ability of such programs to correctly process data.

The university has established a Y2K Coordinator to facilitate Y2K remediation efforts. The university has assessed the impact of Y2K on its computer systems and other electronic equipment. Computer systems are defined as both (1) programmed application systems that provide fiscal and administrative services and (2) supporting hardware and software computer systems infrastructure upon which the application systems reside and are processed. Other electronic equipment includes systems and devices other than traditional computer information systems that may utilize embedded chips in their operations.

The university has determined that certain computer systems are mission critical, certain are critical, and certain are supportive. Mission-critical computer systems are those for which there are no reliable manual alternatives, and for which failure to be in Y2K compliance would prevent the university from fulfilling its mission. Critical computer systems are those for which there are manual alternatives, but the university would unlikely be able to perform fully or efficiently the functions manually because of the volume of manual activity that would be required. Supportive computer systems are those for which there are manual alternatives and the university expects to be able to perform such functions manually, if necessary.

The university has identified the following mission-critical computer application systems:

- UWA systems comprise the business-related systems of the university: general ledger, procurement, human resources, and budget. Campus administrative systems are those related to students: recruitment, admissions, registration, scheduling, accounts receivable, and grades.

The university has subjected those systems to the following stages of work to address Y2K issues:

The University of Tennessee
Required Supplementary Information
Year 2000 Disclosures (Cont.)

- Awareness stage – establishing a budget and project plan for dealing with the Y2K issue.
- Assessment stage – identifying the systems and components for which Y2K compliance work is needed.
- Remediation stage – making changes to systems and equipment.
- Validation/testing stage – validating and testing the changes that were made during the remediation stage.

All of the UWA mission-critical computer applications systems identified above have completed the validation/testing stage. All campus mission-critical administrative systems have completed the validation/testing stage except those noted below:

- UT Knoxville: The academic history, student records, advising, institutional research, and student record master systems are in the remediation stage. We expect all of these to complete the validation/testing stage by the end of September 1999.
- UT Martin: The Legacy financial aid system requires remediation. The financial aid system is expected to be replaced with a new Y2K compliant system by September 1999.
- UT Memphis: The library system requires remediation. The library system is expected to be replaced with a new Y2K compliant system in September 1999. A telephone system software upgrade to ensure Y2K compliance will occur in July.

The university's mainframe computer system and local area networks (LANs) provide the supporting computer systems infrastructure upon which the university's application systems reside and are processed. The mainframe and LANs represent multiple hardware and software components to include a central processor, workstations, and network operating system. The university determined that these components are currently in the validation/testing stage.

The university identified other electronic equipment items as critical to conducting operations. The university determined that these systems are currently in the validation/testing stage.

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Required Supplementary Information
Year 2000 Disclosures (Cont.)

The completion of all stages identified as necessary to address the Y2K issue is not a guarantee that systems and equipment will be year 2000 compliant.

The university's Y2K initiatives did not result in the commitment of significant financial resources as of the end of the university's reporting period. The university is not aware of any circumstances or costs to achieve Y2K compliance that will have a negative impact on the operations or financial status of the institution.